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OP-ED CONTRIBUTOR

Choose and Lose

By BARRY SCHWARTZ

Swarthmore, Pa. — THERE are three arguments being made in favor of privatizing part of Social Security. First, the Social Security Trust Fund needs money and privatization will, in the long run, increase the amount of money available to retirees. Second, privatization will give people choice, and choice is good. And third, "it's your money," and you ought to be able to do with it as you wish.

Each of these arguments is dubious, or disingenuous, or both.

Though experts differ on the urgency and the severity of the problem, most everyone agrees that the trust fund will eventually run out of money unless we do something. Two obvious and painful things we can do are decrease benefits or increase payroll taxes. Privatization, it is argued, solves the problem without the pain. Equity investments return about twice as much, historically, as Treasury bills. So by allowing people to put some of their payroll taxes into equity investments, we will increase the value of that part of their retirement account so we can then decrease the benefits paid out by the standard Social Security program and still leave retirees better off.

There are several problems with this argument, however. For starters, there is no guarantee that equities will return more than Treasury bills. One of the reasons that equities have a higher rate of return than other types of investments is that investors have to be compensated for taking risks. Perhaps equities will outperform Treasury bills in the long term but that doesn't mean that they will be outperforming Treasury bills at the specific moment you retire.

For example, a person who retired in 2000 after a lifetime of investing half in stocks and half in bonds would have had 50 percent more in his account than a person making the same investments who retired in 2003. A difference like this could mean that the lucky retiree can afford both food and medicine while the unlucky one must choose between them. The risk inherent in equity investments is unavoidable unless you can leave the investment alone indefinitely, which, of course, most retirees can't do.

What's more, the administrative costs of keeping track of these private accounts, according to President Bush's Commission to Strengthen Social Security, will be 10 to 30 times the cost of administering the current system, eating up almost all of the hypothetical gains that equity investments could provide.

Finally, even if we grant the advantages of putting trust fund money into equities, this is something that the government could do without privatizing anything by doing the investing itself. The government as investor can ride out risks better than any individual investor, and administrative costs would be vastly reduced. Only brokerage houses would suffer - from lost commissions. Thus investing in equities, which might be a good idea, is logically independent of privatization, which is a bad one. The Bush administration is deliberately conflating them.

This brings us to the second argument in favor of privatizing Social Security: giving people options makes them better off. There is now accumulating evidence that choice isn't always good. Whether people are choosing jam in a grocery store, essay topics in a college class, or even potential partners in an evening of "speed dating," the more options they have, the less likely they are to make a choice. In other words, increasing options induces people to opt out of choosing altogether, and this comes into play when people decide how to invest their money for retirement.

A study by Sheena Iyengar, a psychologist, and Wei Jiang, an economist, has shown that when employers increase the number of funds available to employees for voluntary 401(k) investments, the rate of participation goes down by 2 percent for every 10 funds offered. And this is true even when participating employees get free money - matching money - from employers.

So whereas there is no denying that choice is sometimes good, a case must be made for the specific benefits of choice in each particular context, rather than just assuming that the more choice people have, the better off they are. The appropriately abysmal early public response to the administration's Medicare prescription drug choice plan provides ample reason to suspect that many people will not regard being able to choose their Social Security investment instruments as a blessing.

This brings me to the final defense of privatization: the payroll taxes you pay are your money, and you ought to be able to do what you like with your money. This, I suspect, is the real justification behind the move to privatize, and it is the worst reason of all. The payroll tax is not "your" money; it's our money. Social Security was created as an insurance scheme, not a pension scheme. It was meant to provide a safety net, to protect the unlucky from immiseration in old age. The benefits we get are not payouts from accounts in which we have accumulated our own private stash. What we get is largely determined by what we earned, but we keep getting it even after we've taken out every penny we put in. And if we happen to die early, someone else reaps the benefits of our contributions.

The Bush administration should be honest with the American people and ask us if we want to do away with Social Security, without pretending that privatization will solve the problem of financing the trust fund without pain. I suspect that the American people would reject this effort to transform their "old-age insurance" into another opportunity to roll the dice in the investment casino.

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